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SUBJECT: Implementation of Nicaragua's 2007 Budget

REF: A) MANAGUA 1783, B) MANAGUA 1771

¶1. (SBU) Summary: President Ortega's 2007 $1.5 billion national budget, approved by the National Assembly in March, does not differ markedly from the October 2006 version presented by the Bolanos administration. The Sandinista budget did shift additional resources toward health, education and agriculture. The Ministry of Finance's (MHCP) semi-annual report on budget implementation claims that the obvious under-spending on capital projects is due to slow disbursement of assistance monies. Indeed, foreign donors have been reluctant to fund capital projects with the Sandinista government without reasonable performance guarantees and a viable government economic development plan. The new IMF agreement should provide some assurance to donors, but will not solve implementation problems caused by the wholesale dismissal of technically qualified civil service employees by the incoming Sandinista government. End Summary.

NicaraguaQs 2007 Budget

¶2. (U) President OrtegaQs 2007 National Budget, approved by the National Assembly in March, totals USD 1.5 billion and does not differ markedly from the version drafted by the Bolanos administration in October 2006 with both staying within IMF parameters. The Ortega budget increased spending by just USD 42.1 million, funded by a USD 39.4 million increase in tax revenue in the first quarter (Q1) of 2007 (a 16.2% increase over Q1 2006), and USD 28.8 million in donor assistance not confirmed until after October
¶2006. The Sandinista government did shift USD 75 million between ministries to augment social spending. It also "saved" USD 56.7 million through a reduction in civil service wages, including ministers and the president; a reduction in representational expenses, GON travel, cellular phone use, and the use of credit cards; as well as cuts in the purchase of goods and services.

¶3. (U) The Sandinista government's spending prioritizes the Ministries of Health, Education, and Agriculture, whose budgets increased by 3.5%, 12% and 24.5%, respectively. The up tick for the Ministry of Agriculture reflects the incorporation of the GovernmentQs signature poverty reduction program "Zero Hunger" (Ref A).

¶4. (U) The following is the budget breakdown for the largest recipients:

Ministry	USD(millions)	% of Budget
Ministry of Health	218.9	14.3

Ministry of Education	210.3	13.6
Ministry of Transportation	101.8	6.6
Transfer to Universities	81.3	6.0
Transfer to Municipalities	69.6	5.0
Ministry of Government	65.9	4.3
Supreme Court	55.4	4.0
Ministry of Agriculture	53.7	3.5
Ministry of Defense	39.0	2.5
Rural Development Institute	27.9	1.8
Emergency Social Inv Fund	20.5	1.3
National Assembly	17.9	1.1
Road Maintenance Fund	15.6	1.0
Ministry of Energy and Mines	14.9	1.0
Ministry of Environment	12.7	0.8
Presidency	11.9	0.8

A Drop in Capital Spending?

¶5. (SBU) The Ministry of Finance's (MHCP) semi-annual report on budget implementation notes that the GON has been under-spending its capital budget, a fact which some local economists and National Assembly Deputies claim has caused the current contraction of the construction sector, thereby leading to an overall slowing of the economy. While GON capital spending is below 2006 January-June levels (29.4% vs. 35.5% of budget allocations), the contraction of the construction sector is much more pronounced (-7.8% vs. 6.8% growth in 2006), and likely cannot be blamed completely on the slow pace of GON capital spending. Also, despite the low numbers in the construction sector, overall economic growth, as measured by a monthly economic activity index, has been steady at 4.2% for 2007, only a slight drop from 4.3% for 2006 (for the same time period).

The GON Blames the Donors

¶6. (U) The MHCP budget implementation report places most of the blame for capital budget under-spending on slow disbursements by donors, as many infrastructure investment projects depend heavily on foreign assistance. As of July 25, donors have only disbursed 21.9% of budgeted loans and donations (USD 128.5 million of USD 586 million). (Note: External borrowing and foreign assistance account for 15% and 15.7% of the total budget, respectively. End note). As a result, capital spending tied to foreign assistance enjoys only a 22.6% implementation rate.

¶7. (SBU) Indeed donors are reluctant to disburse funds to the Sandinista government without sufficient performance guarantees or an acceptable economic development plan. They complain that the lack of a coherent economic roadmap and the veil of secrecy surrounding GON operations do not provide the necessary confidence that foreign assistance will be used well. In fact, it was six months into the current Ortega administration before the GON convened the first Donors' Roundtable (the group used to meet bimonthly.) Donors have also been waiting for the GON and the IMF to conclude a Poverty Reduction and Growth Facility (PRGF), before considering further disbursements. Now that the agreement is negotiated, disbursements and implementation should increase (Ref B).

¶8. (U) The MHCP report mentions in passing that "ineffective implementing agencies" (not defined) and the change in GON policy priorities may also have contributed to the lack of capital spending. The latter excuse is used to explain the delays in implementing the capital budgets for health (20.9% implementation rate vs. 27.9% in 2006), education (28.8% vs. 43.5% in 2006), and the newly created Ministry of Energy (10.7%).

Quality Spending is a Problem

¶9. (SBU) The real issue is the quality of GON capital expenditures. IMF ResRep Humberto Arbulu Neira states that the GON buries many salaries in its capital accounts because the previous administration transferred them there to meet savings targets under the prior IMF agreement (Ref B). Therefore, not all capital spending translates into infrastructure spending. Both donors and local economists also point to the replacement of specialized staff with FSLN party

loyalists who do not possess the knowledge and/or skills to execute infrastructure investment. (Note: According to some reports, 2,000 of 5,000 civil servants at the ministry level have been fired or pressured out since January and this figure does not include other government employees such as teachers or healthcare workers covered by separate personnel legislation. End note.) Aggravating the situation, FSLN ministers are often reluctant to embark on projects without the approval of the Presidency, creating huge bottlenecks and delays in implementation.

Comment

¶10. (SBU) Budget implementation, and the quality of GON spending, is a key issue for the IMF and the donors providing direct budget support (BSG). All have expressed concern regarding the weakening of the civil service as the result of so many experienced government employees being replaced by party loyalists, and of efforts by the Presidency to concentrate all decision-making power. We understand some donors are considering discontinuing direct budget support. Despite these concerns, the new PRGF, as negotiated, allows the GON to increase capital spending by USD 155 million, 84% more than in ¶2007. The IMF has also agreed to provide technical assistance to the GON to purge non-capital items such as salaries from the capital budget.

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